United Nations DP/2006/32

Executive Board of the United Nations Development Programme and of the United Nations Population Fund

Distr.: General
15 May 2006

Original: English

Annual session 2006
12 to 23 June 2006, Geneva
Item 16 of the provisional agenda
Internal audit and oversight

UNOPS: Report of the UNDP Office of Audit and Performance Review to the UNOPS Executive Director on internal audit services in 2005*

Contents

Chapter		*Page*
I.	Introduction	2
II.	Key activities: highlights	2
III.	Implementation of the audit work plan in 2005	5
IV.	Audit of organizational units, functions and project activities	6
V.	Audits of project financial statements under management services agreement	8
VI.	Overview and categorization of audit recommendations	9
VII.	Management reviews	12
VIII.	Investigation services	13

* The compilation of data required to present the Executive Board with the most current information has delayed submission of the present document.

Note: Annexes 1-4 of the present report are available at the Executive Board website.

06-35080 (E) 070606

I. Introduction

1. The Director of UNDP, Office of Audit and Performance Review (OAPR) is pleased to provide the Executive Director of UNOPS with the annual report on internal audit and investigation services for the year 2005.

2. This annual report sets out the work of OAPR for 2005 and the initiatives undertaken to strengthen oversight in UNOPS. These initiatives include the steps taken to help management in strengthening the governance of oversight, improve planning and execution of internal audit; enhance coordination with management, the external auditor and other oversight bodies. It also sets out the results achieved in auditing selected organizational units, functions and project activities, as well as the results achieved in rendering management and advisory services.

3. In line with the actions taken to respond to the requests made by the Executive Board, this report includes a prioritization of audit recommendations based on risks, an analysis of issues based on frequency of occurrence, and a further analysis of the underlying causes of these audit issues. In addition, the status of the most frequent and highest priority recommendations has been updated based on the framework approved in the Executive Board decision 2004/39. The management responses to audit recommendations made between 2004 and 2005 are also presented in this report.

II. Key activities - highlights

A. Internal audit coverage and initiatives

4. The Project Services Audit Section (PSAS) of OAPR provides internal audit services to UNOPS pursuant to the memorandum of understanding between UNOPS and UNDP effective on 1 January 1997. These services are provided in conformity with the relevant provisions of the UNOPS financial regulations and UNDP rules, which are applicable at this time, mutatis mutandis, to UNOPS.

5. Overall, OAPR successfully carried out the majority of the assignments set out in its approved work plan. In 2005, 26 reports were issued, 22 of which were initiated and completed during the year, while the remaining four pertain to audits carried forward from 2004. These audits and related significant issues are described in chapters III, IV and V of the present report. An overview of recommendations is presented and categorized in chapter VI. The significant issues, recommendations made and actions taken by management are summarized in annexes 1 to 3, based on the framework approved in EB decision 2004/39, which are available on the Executive Board web site.

6. Following the appointment of a new director in November 2004, OAPR went through a team-building and change management process during 2005. A number of initiatives were introduced, including raising the profile of internal audit by increasing the role of OAPR in strengthening oversight in UNOPS. The key activities and initiatives are described in the succeeding paragraphs.

B. Establishment of the UNOPS Risk Management and Oversight Committee

7. In an organizational directive dated 6 May 2005, the former Executive Director established the Risk Management and Oversight Committee (RMOC), which is an important element of governance and oversight. The main purpose of the committee is to assist the Executive Director "in fulfilling his/her responsibilities regarding financial management and reporting, internal controls, risk management, and matters relating to external and internal audits". This is the first time UNOPS has had such committee, which is considered a 'best practice' in governance and oversight.

8. OAPR participated actively in establishing the RMOC, preparing the terms of reference and identifying qualified external members. The membership consists of three senior UNOPS staff members and two external members, as well as two ex-officio members. The OAPR Director is one of the ex-officio members and, in this capacity, actively supported and participated in strengthening the work of the RMOC in 2005.

9. The RMOC held four meetings in 2005 and discussed key issues that involved, among others: the ongoing organizational restructuring and the transition programme; delegation of authority; accountability issues; internal controls; insurance coverage and associated risks; progress of internal audit work; external audit work and status of implementation of external audit recommendations; the effect on UNOPS of the investigation by the Independent Inquiry Committee into the United Nations Oil-for-Food Programme, and Atlas-related matters.

10. During the four meetings, the RMOC made several recommendations, which the Executive Director agreed to implement. These included two key actions resulting in organizational directives towards strengthening internal control and accountability, as follows:

11. *Internal control framework*. The scope of the framework at this stage primarily addresses business processes in Atlas and compensating controls. It includes components of internal control, including planning, monitoring, communication, and segregation of duties.

12. *Fraud policy*. The policy highlights UNOPS commitment to prevent and detect fraud. Its scope goes beyond staff to include consultants, vendors, contractors and any other parties having business relationships with UNOPS. To facilitate reporting of fraudulent activities, UNOPS established a confidential whistleblower hotline, through telephone and e-mail, which is managed by the Office of Legal Services.

C. Proactive provision of advisory services

13. A number of advisory services were rendered by OAPR to headquarters and regional offices, which included providing comments on policies and procedures on the following key areas: a) revision of the financial regulations and rules, b) internal control framework, c) fraud policy and fraud investigation procedures, d) delegations of authority, e) procurement matters, such as, on the contracts advisory committee process, long-term agreements, disposal and handover of project equipment, f) proposed single project approach in Atlas, g) access to UNOPS personnel records by clients, and h) handover of projects to another implementing agency.

14. OAPR also continued to assist in reviewing memorandum of understanding and agreements, focusing particularly on audit clauses. The significant ones in 2005 included the proposed implementation arrangements with: (a) the Inter-American Development Bank, and (b) the World Bank. As well, OAPR provided briefings on audit and oversight regime in UNOPS to visiting officials from government entities and other United Nations organizations.

D. Commissioning of an Atlas post-implementation review

15. OAPR commissioned an assessment, "Review Controls and Identify Risks in a Post-Implementation PeopleSoft Environment", that included UNDP, UNOPS and UNFPA. The review was conducted by Cedar Enterprise Solutions Inc., to identify significant risks in the key areas of control framework definition, business process controls and application security controls. It covered the way Atlas was set up and implemented in the areas of finance, human resources, and payroll.

16. The review resulted in 80 agency-wide recommendations. Among the high priority ones related to the global security management system, assessment of existing reports and queries, revisiting the entire disbursement processes, and addressing the factors that contribute to the bank reconciliation problems. The UNOPS management responses to the observations had been positive and were incorporated in the final report.

E. Strengthening coordination with the United Nations Board of Auditors

17. The role of the United Nations Board of Auditors (BOA) is a main element of the audit regime in UNOPS. OAPR has closely coordinated with BOA in the formulation of the annual audit work plan for 2005, including consultations on the priorities so as to complement audit coverage and follow-up of relevant recommendations. These consultations also included timely sharing of audit results which would contribute to more reliance being placed by BOA placing on the work of internal audit.

18. In 2005, the scope of the audit work plan took into consideration the observations of BOA, which are contained in the financial report and audited financial statements for the biennium ended 31 December 2003. In coordination with UNOPS management, OAPR conducted a review to prioritize the external audit recommendations. As well, we carried out an assessment of the critical areas relating to the reconciliation of account balances, as part of the audit of the finance activities, which assignment started during the last quarter of 2005.

F. Cooperating with the Independent Inquiry Committee on the United Nations Oil-for-Food Programme

19. The audit work plan was notably affected by the investigation of the Independent Inquiry Committee (IIC) on the United Nations Oil-for-Food Programme, considering that UNOPS is one of the implementing agencies. OAPR cooperated with the IIC through, among others, provision of audit reports and related working papers, responding to questionnaires and participating in consultation meetings with the IIC and within UNOPS. These activities were of high priority, which lasted for almost eight months until the IIC reports were issued in September 2005. The outcome of the IIC investigation has a significant effect on the governance and oversight mechanisms in the United Nations organizations.

20. OAPR reviewed the IIC reports and requested UNOPS to prepare an analysis to identify specific issues that affected UNOPS. Such analysis, linked to the IIC report that is available in its website, was presented to the RMOC. The main issue was that the IIC considered that the rate set for the reimbursement of administrative fees as high and all UN organizations reimbursed the OFFP, including UNOPS for the total amount of $14.9 million.

G. Improving the risk-based audit planning and audit methodologies

21. OAPR updated and refined its risk assessment model for UNOPS operations, which was submitted to the RMOC in December 2005. This model was used for identifying the activities to be included in the audit work plan for 2006. The purpose of using a risk-based audit planning approach is to ensure that audit resources are applied in areas of operations considered high risk, that is, they would negatively impact on the successful achievement of the organization's objectives. The risk assessment model will continuously be refined in 2006.

II. Strengthening the internal audit staffing capacity

22. The significant changes in the staffing of PSAS during 2005 were as follows:

(a) The Chief of Section post was filled in July 2005.

(b) Resignation of an audit specialist in March 2005 and a replacement was hired who joined a year later in April 2006.

(c) Unfreezing of an audit specialist post in headquarters, which was reclassified as an international post, to be outposted at the UNOPS Dubai office. This was approved by the Executive Director a.i. based on the recommendation of the RMOC to increase the audit coverage for operational activities in post-conflict and crisis programme countries, such as, in Afghanistan and in the Tsunami-affected areas. The recruitment process has been initiated and it is expected that a candidate will be in post by mid-year 2006.

23. The departure of one audit specialist in March 2005 resulted in a reduction in capacity during the year whereas there was an increase in workload (taking into account the number of audit assignments and the OAPR initiatives to enhance the provision of internal audit services). To supplement its staffing capacity, PSAS focused on the high risk areas and engaged audit consultants, particularly in carrying out project audits.

24. Starting in 2006, the addition of the audit specialist to be outposted at the UNOPS Dubai office will strengthen the internal audit capacity. Accordingly, the PSAS staffing posts as at the end of 2005 and for 2006 consists of one chief, three audit specialists and one assistant (all posted at headquarters), and one audit specialist (posted at the UNOPS Dubai office).

25. With the goal of doing more with less, OAPR will continue to assess its staffing resources and will make recommendations to the Executive Director based on a risk-based audit planning and the current financial situation of UNOPS.

III. Implementation of the audit work plan in 2005

26. The audit work plan for 2005 was prepared at the start of the year on the basis of a risk-based planning process. In conducting this risk based planning process,

OAPR performed a number of actions, which included: (a) organizing consultations with the Executive Director, Deputy Executive Director and Director of Global Operations and other key officials of the organization; (b) analysing the ongoing restructuring of UNOPS and business trends, including recent decisions of the Executive Board; (c) itemizing the priorities that were determined during the OAPR management planning meeting in December 2004; and (d) developing a methodology for identifying and measuring the risk factors such as, delivery or volume of operations, staffing size, location of the unit, outcome and date of previous audits, nature of the operation.

27. In 2005, the audits and reviews covered operational activities at headquarters and in the field, including those under management and other support services arrangements (MSA), as shown in Table 1.

Table 1. Internal audit services provided to UNOPS in 2005, by type of audit

Type of audit	In process 01/01/05	Audits Initiated	Final reports released	In process 31/12/05
Full scope or limited scope audit of headquarters or field organizational unit or projects	2	12	12	2
Project financial statement audit	-	12	12	-
Management review	2		2	-
Total	4	24	26	2

28. A summary of the audits and analysis of the significant issues, based on the 24 final audit reports released in 2005 are shown in chapters IV and V of this report. A summary of the two management reviews is shown in chapter VII.

IV. Audit of organizational units, functions and project activities

29. Pursuant to Executive Board decision 2004/39 on internal audit and oversight, the significant issues identified in the internal audit reports, which were released in 2005, are presented in tabular form, in annexes 1 to 3, available on the Executive Board website. The concerned UNOPS organizational units provided their strategy in addressing the issues, which include the timeframe and the indicator of progress or completion. These audits are briefly described in the succeeding paragraphs.

30. Twelve reports were issued on the audit of a field organizational unit and projects, and issues that were considered significant, as well as management's response, strategy and timeline for corrective actions, are presented in annexes 1 and 2. On the basis of what is contained in these reports, OAPR considered that the overall level of internal control in six audits are satisfactory and the other six as partially satisfactory. The definition of the standard audit ratings is shown in annex 4 (it is to be noted that the audit ratings are now being harmonized by the internal audit offices of the UNDG group, namely, UNDP, UNFPA, UNHCR, UNICEF and WFP), also available on the Executive Board website.

31. Three of the twelve audits are briefly described, as follows:

(a) Limited scope audit of the Afghanistan Programme Implementation Facility (APIF). The audit, which focused on a review of 2004 financial transactions, resulted in an overall rating of partially satisfactory. Key issues pertain to the lack of an administrative budget to properly allocate APIF costs, the need to establish well-defined criteria and procedures relating to the significant use of advances recoverable locally, and the need to strengthen the monitoring of such advances.

(b) Limited scope audit of a cluster of projects implemented in Myanmar. OAPR considers the overall level of internal control to be partially satisfactory. Key issues include: (i) delays in submission of imprest account records to headquarters; (ii) unliquidated obligations at year end were not fully supported by valid commitments resulting in overstatement of project delivery reports; (iii) significant delays in settling advances; and (iv) project personnel entered into subcontracts on behalf of UNOPS without having the requisite delegation of authority.

(c) Follow-up audit on the project in Senegal and Mauritania (RAF/98/G31). The rating was satisfactory considering that most of the audit recommendations in the previous report (2004 report with a deficient rating) had been implemented. The only outstanding issue pertains to the requirement for an annual external audit by an independent auditor, which contradicts the single audit principle.

32. Nine of the twelve audit reports pertain to the horizontal audit of the Small Grants Programme (SGP) of the Global Environment Facility. Of the nine audits, five resulted in a satisfactory opinion (Costa Rica, Ecuador, Guatemala, Kenya and Uganda) and four resulted in a partially satisfactory opinion (Brazil, Egypt, Tunisia, and Tanzania). The following key issues were specifically noted to be common in the audit of the nine SGP projects (a complete listing is presented in annex 2, available at the Executive Board website):

(a) The contract with the host institution has lapsed, and no new contract was finalized to cover further service, resulting in a risk of disruption in operational activities.

(b) Lack of clarity on the extent of responsibilities of the host institution, which poses the risk of misunderstanding among the major parties.

(c) Lack of clarity and differences of opinion between the host institution and the UNOPS operating division with regard to the contract price and payment terms, specifically with respect to provision of original supporting documentation and of project personnel.

(d) A key control requirement that a certification of the receipt and acceptance of the relevant progress reports be made had not been complied with; thus, the audit team had no audit trail or assurance that payments had been made based on valid conditions.

33. As indicated in the management comments shown in annex 2, available at the Executive Board website, appropriate actions have been taken to address the above issues. In particular, the guidelines are being revised so as to clarify issues relating to host institution arrangements. In addition, a directive was issued to project personnel with a view to strengthening the controls on payment processing.

V. Audit of project financial statements under management services agreement

A. Management services agreements financed by the World Bank

34. As in previous years, OAPR conducted audits of project financial statements relating to activities implemented by UNOPS under management services agreements (MSAs) and financed from World Bank loans or administered funds. In 2005, audits were undertaken for the following eight MSA activities: (a) four MSA activities under letters of agreement between the borrowing government and UNDP, in which UNOPS is the implementing agency, with total expenditure for the activity year 2004 of $14.2 million; and (b) four MSA activities under letters of agreement between the Nile Basin Initiative (NBI) and UNOPS, with total expenditure for the activity year 2004 of $1.5 million.

35. The resulting overall audit opinions on the eight audits are, as follows:

(a) In five audits (ARG/98/R01, ETH/03/R01 and three NBI projects), OAPR expressed the opinion that the statement of expenditure and status of funds for the projects presented a fair view of the operations.

(b) In two audits, OAPR qualified its opinion: (i) in the case of an NBI project, a significant amount (in terms of percentage) of the reported expenditure represented encumbrances that were no longer valid and should have been closed at year-end 2004 (subsequent to the audit, the action unit closed the invalid encumbrances); and (ii) in the case of ARG/97/R01, expenditures were in excess of funds received, resulting in a material fund deficit (which is contrary to the financial regulations).

(c) In one audit (TUR/95/R01), OAPR expressed the opinion that the statement of expenditure did not present a fair view of the operations because of the material amount of encumbrances that were not valid as at year end 2004.

36. In addition to the above eight reports, OAPR prepared a consolidated report containing detailed observations and recommendations. A table presenting significant issues in this regard is presented in annex 3.

B. MSAs financed by the International Fund for Agricultural Development

37. OAPR carried out an audit of the project financial statements of the MSA activities SOM/01/R74 and the Burtinle water supply (GLO/03/R71), which are financed by the International Fund for Agricultural Development (IFAD). The audit was conducted as required by the MSA and related financing agreement between IFAD and UNOPS. The total expenditure amounted to $1.2 million.

38. In both audits, OAPR qualified its opinion. In the case of SOM/01/R74, the expenditures were in excess of funds received, resulting in a fund deficit (which is contrary to the financial regulations). In the case of GLO/03/R71, a certification of services rendered for a material amount of expenditure was not made available at the time of the audit. Subsequent to the audit, the action unit submitted the certification to the audit team.

39. In addition to the above two reports, a consolidated report containing detailed observations and recommendations was prepared. A table presenting significant issues in this regard is presented in annex 3.

VI. Overview and categorization of audit recommendations

A. Management responses and implementation of the 2005 audit recommendations

40. The audit reports issued in 2005 contained a total of 157 recommendations for improving internal controls and organizational efficiency. The UNOPS organizational units concerned provided their written responses to the contents of the draft of the audit reports, specifically on all the 157 recommendations, with an account of actions taken, or contemplated, to implement these recommendations.

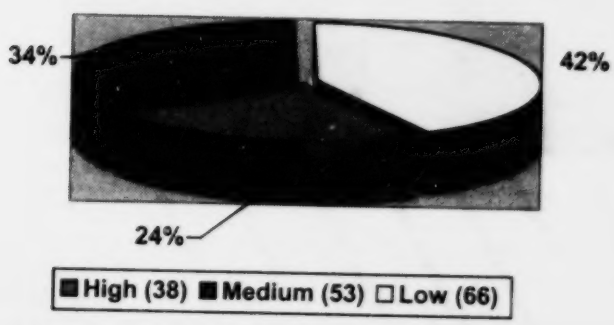
41. Based on the management responses, the concerned organizational units indicated that actions have been taken or are being taken to address almost all of the audit issues and recommendations.

B. Prioritization of audit recommendations

42. In order to assist management in prioritizing the implementation of action to address the issues, OAPR provided an analysis in each audit report of the recommendations, by level of importance. Figure 1, which illustrates the categorization of the 157 recommendations, shows that 38 recommendations (or 24 per cent) are considered of high importance, 53 (or 34 per cent) are of medium importance and 66 (or 42 per cent) are of low importance.

Figure 1. Prioritization of audit recommendations by importance
Audit reports issued January to December 2005

High	38
Medium	53
Low	66
Total	157



High	Action considered imperative to ensure that UNOPS is not exposed to high risks (that is, where failure to take action could result in critical or major consequences for the organization).

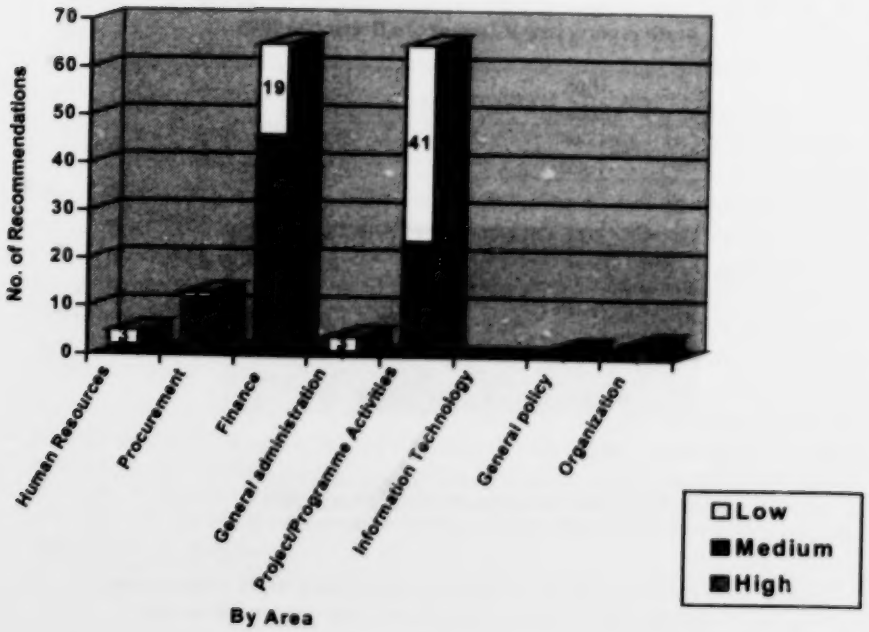
Medium	Action considered necessary to avoid exposure to significant risks (that is, where failure to take action could result in significant consequences).
Low	Action that is considered desirable and should result in enhanced control or better value for money.

C. Frequency and prioritization of audit recommendations

43. OAPR further analysed the 157 recommendations to identify the frequency of occurrence by area. Figure 2 shows the distribution of recommendations by area, which, coupled with the level of importance, would provide information on the areas that need to be addressed by management.

44. In this regard, the areas of finance and project or programme implementation have the greatest number of audit recommendations considered high priority. A further analysis indicates that most recommendations in the finance area pertain to imprest account operations; advances recoverable locally; project payments; and Atlas-related financial procedures. Most of the recommendations in the project/programme area are common in the horizontal audit of SGP programme activities, specifically on grant selection and approval procedures and on non-compliance or lack of clarity relating to certain provisions of the operational guidelines.

Figure 2. Frequency and prioritization of audit recommendations
by area and by level of importance
Audit reports issued January to December 2005

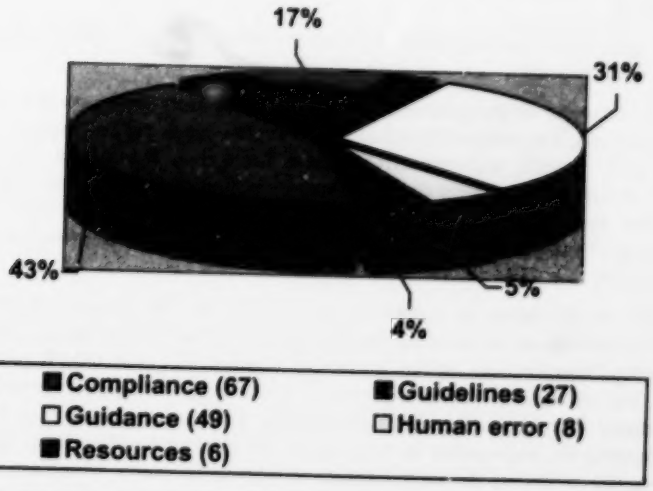


	Level of importance			Total
	High	Medium	Low	
Human resources	-	2	3	5
Procurement	9	3	1	13
Finance	18	28	19	65
General administration	-	1	3	4
Project/programme activities	9	15	41	65
Information technology	-	-	-	-
General policy	1	1	-	2
Organization	1	2	-	3
Total	38	53	66	157

D. Causes of audit issues

45. As illustrated in figure 3, analysis of the causes of audit issues indicated that the most common (43 per cent) is lack of compliance to pertinent regulations, rules, procedures and guidelines. The other main cause (31 per cent) was lack of guidance in respect of operational procedures. These two significant causes have been found to be common in the horizontal audit of the nine SGP projects.

Figure 3. Categorization of recommendations by cause
Audit reports issued January to December 2005



Compliance	Failure to comply with prescribed UNOPS regulations, rules and procedures.
Guidelines	Absence of written procedures to guide staff in performing their functions.
Guidance	Inadequate or lack of supervision by supervisors.
Human error	Mistakes committed by staff entrusted to perform assigned functions.
Resources	Insufficient resources (funds, skill, staff) to carry out an activity or function.

E. Follow-up on the implementation of previous year's audit recommendations

46. As requested by the Executive Board in its decision 2005/19, OAPR followed up on the implementation status of previous internal audit recommendations, specifically those considered significant issues in the 2004 report. The 2004 report contains 72 recommendations, of which 29 (or 40 per cent) were of high priority, 39 (or 54 per cent) of medium priority and four (6 per cent) of low priority.

47. In general, OAPR requests action units to provide periodic updates on the status of implementation and reviews the status in subsequent audits or through a desk review. Based on that approach, the implementation rate for the audits in 2004 showed that:

(a) Of the total of 72 audit recommendations, 56 (or 78 per cent) were implemented, while the remaining 16 (or 22 per cent) are still ongoing or under implementation; and

(b) In terms of the 29 recommendations deemed high priority, 25 (or 86 per cent) were implemented and the remaining 4 (or 14 per cent) are still ongoing or under implementation.

48. We consider the high implementation rate as a positive indication of progress achieved to date in addressing the issues and related audit recommendations.

VII. Management reviews

49. In addition to internal audits, two reports were issued in 2005 on the following management reviews:

(a) Review of the processing of imprest accounts in the context of drawing lessons learned. Key issues identified in this review were: (i) the lack of clarity with respect to the specific and respective roles of the former Asia office and the finance division at headquarters regarding regular reconciliations; (ii) the fact that the Asia office has no access to the general ledger trial balance; and (iii) inadequate monitoring of the status of imprest account reconciliation by the finance division at headquarters.

(b) Participation of OAPR in the review by the finance division of the internal control framework using the framework of the United States Committee of Sponsoring Organizations of the Treadway Commission. The OAPR portion of the review was conducted in the context of improving the control environment for procurement and imprest account operations. Key issues pertain to: (i) properly implementing the segregation in Atlas of the purchasing function from the receiving function; (ii) reviewing the large number of imprest accounts, which are operated on a single signatory basis to ensure that proper compensating controls are in place; and (iii) imprest account reconciliation issues.

50. In response to the above key issues, UNOPS management took action, particularly in connection with the imprest account processing and reconciliation activities.

VIII. Investigation services

51. In 2005, the investigation section of OAPR received and investigated two complaints pertaining to UNOPS personnel. The first involved allegations against personnel under a project in the Democratic Republic of the Congo. Upon receipt of the investigation report, the Office of Legal Services reported that appropriate action had been taken by management. The second case pertains to allegations against a project coordinator in China. The case is still being reviewed to ascertain whether or not there is prima facie case of financial irregularities.